BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
MAUDE PETERSON)

For Appellant: Garthe Brown
Attorney at Law

For Respondent: Bruce W. Walker
Chief Counsel

James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Maude Peterson against proposed assessments of additional personal income tax in the amounts of $3,074.25 and $22,544.31 for the years 1973 and 1974, respectively.

The sole question for decision is whether appellant was entitled to a credit against her California personal income tax liability for taxes paid to the State of Oregon on certain dividend income.

Appellant is a resident of Laguna Beach, California. She owns stock in Webfoot Fertilizer Company, Inc. (Webfoot), a closely held Oregon corporation which does business primarily in Oregon and Washington. During the years in question appellant also served as an officer and/or director of Webfoot.

For federal income tax purposes Webfoot elected to be taxed in 1973 and 1974 as a small business corporation, pursuant to subchapter S (§§ 1371-1379) of the Internal Revenue Code of 1954. The effect of such an election is to treat the corporation essentially as if it were a partnership, with the individual shareholders rather than the corporation being taxed on the corporate income. In Oregon, corporations opting for subchapter S treatment under the federal income tax law are similarly treated for state income tax purposes. However, a nonresident shareholder of such a corporation issubject to Oregon income tax on his share of the corporate income, as such income is characterized as being from Oregon sources. (Or. Rev. Stat. § 316.127, subd. (5).)

In her 1973 California personal income tax return appellant reported $9,900 in salary payments from Webfoot and $78,750 in dividends received from that company. She claimed a tax credit of $4,323.78 for income tax paid to the State of Oregon on those amounts. Similarly, in her 1974 return she reported $19,500 salary and $243,000 in dividends.received from Webfoot. In that return she claimed a tax credit of $24,415.65 for Oregon income tax paid on those amounts. Respondent reduced the total tax credit claimed for each year, allowing that portion of the credit relating to Oregon tax paid on appellant's salary payments from Webfoot but disallowing the remainder, which related to Oregon tax paid on the dividend income. That action gave rise to this appeal.

Subject to certain conditions, section 18001 of the Revenue and Taxation Code allows a credit to California residents for net income taxes paid to other states on income also taxable in California. One of several limitations on the availability of the credit is set forth in subdivision (a) of section 18001, which provides in pertinent part:

> The credit shall be allowed only for taxes paid to the other state on income derived from sources within that state which is taxable under its laws irrespective of the residence or domicile of the recipient. (Emphasis added.)

The credit does not apply to income derived from a California source;

It is respondent's position that the dividend income received by appellant from Webfoot constituted income from intangible property which had its source at the residence of the owner of the property. Respondent concludes that appellant's California residency establishes a California source for the dividend income and, consequently, no credit was allowable for income taxes paid to Oregon. For the reasons hereafter stated, we must agree with respondent.

The issue presented by this appeal is controlled by the California Supreme Court's decision in Miller v. McColgan, 17 Cal. 2d 432 [110 P.2d 419] (1941). The question before the court in that case was whether a credit was allowable for a Philippine income tax paid on dividends and gains received by a California resident from his stock in a corporation located in the Philippine Islands. The court determined that no credit was available under the predecessor of section 18001. Its reasoning was that the dividends and gains had their source in the stock itself, and that the situs of that stock was the residence of its owner. In reaching that conclusion the court applied the common law doctrine often followed in determining the taxable situs of intangible assets, mobilia sequuntur personam, i.e., "movables follow the person." We have consistently followed the views set forth in Miller v. McColgan. (See, e.g., Appeal of Stanley K. and Beatrice L. Wong, Cal. St. Bd. of Equal., May 1, 1978; Appeal of John K. and Patricia J. Withers, Cal. St. Bd. of Equal., Sept. 1, 1966; Appeals of Hugh S. and Nina J. Livie, et al., Cal. St. Bd. Of Equal., Oct. 28, 1964.)

-Appellant attempts to distinguish her situation from that of the taxpayer in the Miller case. She argues that as a result of its subchapter S election, Webfoot is treated as a partnership for federal income tax purposes and under Oregon's tax laws. Under those circumstances-, appellant contends that California should also characterize her share of Webfoot's income as partnership income with its source in Oregon where the bulk of the business is conducted.

In several prior decisions we have concluded that an election pursuant to subchapter S or any similar statute of a sister state does not alter the status in California of the corporation or its shareholders, nor does it affect the tax consequences of transactions between them. (Appeals of David W. and Marion Burke, et al., Cal. St. Bd. of Equal., Oct. 27, 1964; see also Appeal of John K. and Patricia J. Withers, supra.) The corporation making such an election remains a corporation for California tax purposes. 1/ Accordingly, we have held that a distribution by a subchapter S corporation doing business in another state to a stockholder residing in California retains its California source under the mobilia doctrine and the ruling of the court in Miller v. McColgan, supra. (Appeal of Estate of Donald Durham, Deceased Margaret M. Durham, Executrix, Cal. St. Bd. of Equal., Nov. 12, 1974; Appeal of Theo and Audrey Christman, Cal, St. Bd. of Equal., Dec. 11, 1973.)

The California Court of Appeal recently reached the same conclusion in Christman v. Franchise Tax Board, 64 Cal. App. 3d 751 [134 Cal. Rptr. 725] (1976). The facts of that case are substantially similar to those presented by the instant appeal. Mr. Christman was a resident of California who owned stock in a family-owned small business corporation operating in Georgia,. In 1968 the corporation made a subchapter S election for federal income tax purposes. Under Georgia law, similar State tax treatment would be afforded the electing corporation if all nonresident shareholders agreed to pay Georgia income tax on their shares of the corporate income. Mr. Christman and the only other nonresident shareholder executed the required agreement. In filing his California personal income tax return, Mr. Christman claimed a tax credit under section 18001 of the Revenue and Taxation Code for the amount of income tax he had paid to the State of Georgia on his share of the corporate income. The Court of Appeal agreed with the Franchise Tax Board that no credit was allowable since, under California law, the income in question had its source in California where Mr. Christman resided, not in Georgia. In reaching that

1/ For this reason we find untenable appellant's contention that section 18006 of the Revenue and Taxation Code has any applicability here. That section concerns the tax credit allowable to a member of a partnership who is taxable on the partnership income for net income taxes paid by the partnership to another state.

conclusion the court reaffirmed the viability in California of Miller v. McColgan, Supra, the rule of mobilia sequuntur personam, and the applicability of that rule to determine the source of the income which Mr. Christman had received from the Georgia corporation.

Although, as appellant points out, the state statutes involved in Christman and the instant appeal are distinguishable in their characterization of the income of an electing small business corporation, we do not believe the differences are material. The holdings in both Miller and Christman make it quite clear that in determining the source of appellant's dividend income we must apply California law. Having done so here, we must conclude that appellant's California residency gave her dividend income from Webfoot a California source, no matter how that income may have been characterized under Oregon law.

Finally, appellant contends that failure to allow the tax credit in the instant case results in double taxation, which penalizes electing small business corporations vis-a-vis partnerships and also violates the intent of the Legislature in enacting the tax credit provisions; These same arguments were summarily rejected by the court in Christman v. Franchise Tax Board, supra, and we likewise find them to be without merit.

On the basis of the above authorities, we conclude that respondent properly denied the tax credits claimed by appellant for the taxes she paid to the State of Oregon on her dividend income from Webfoot.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Maude Peterson against proposed assessments of additional personal income tax in the amounts of $3,074.25 and $22,544.31 for the years 1973 and 1974, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of December, 1978, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member